Supreme Court, U.S.
FILED
SEP 18 2003
OFFICE OF THE CLERK

No. 03-272

IN THE

Supreme Court of the United States

THE DOW CHEMICAL COMPANY,

Petitioner,

v.

THE AES CORPORATION,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF IN OPPOSITION

JAMES W.B. BENKARD
Counsel of Record
FRANCES E. BIVENS
KELLI J. STENSTROM
DAVIS POLK & WARDWELL
450 Lexington Avenue
New York, New York 10017
(212) 450-4000

Attorneys for Respondent
The AES Corporation

183118

COUNSEL PRESS
(800) 274-3321 • (800) 359-6859

COUNTER-STATEMENT OF QUESTION PRESENTED

1. Whether the statutory prohibition in Section 29(a) of the Securities Exchange Act of 1934 against waivers of compliance with the federal securities laws renders "void" as a matter of law non-reliance and merger clauses in a contract for the sale of securities.

STATEMENT PURSUANT TO SUPREME COURT RULE 29.6

Respondent The AES Corporation is a publicly held company. Respondent has no parent corporation and no publicly held company owns 10% or more of its stock.

TABLE OF CONTENTS

	Page
Counter-Statement of Question Presented	i
Statement Pursuant to Supreme Court Rule 29.6	ii
Table of Contents	iii
Table of Authorities	iv
Counter-Statement of the Case	2
A. The Fraud by Dow and Destec	2
B. Proceedings Below	8
REASONS FOR DENYING THE PETITION	12
I. The Third Circuit's Decision Does Not Create Multiple Conflicts with Other Circuits	13
II. The Third Circuit's Decision Does Not Conflict with This Court's Opinion in *Shearson*	18
III. The Third Circuit's Decision Will Not Result in the Negative Consequences for Negotiated Securities Transactions Predicted by Petitioner	20
CONCLUSION	21

TABLE OF AUTHORITIES

Page

Cases

FS Photo Inc. v. Picturevision Inc., 61 F. Supp. 2d 473 (E.D. Va. 1999) 14

Harsco Corp. v. Segui, 91 F.3d 337 (2d Cir. 1996) 15, 16, 17

Jackvony v. RIHT Financial Corp., 873 F.2d 411 (1st Cir. 1989) 13

Jadoff v. Gleason, 140 F.R.D. 330 (M.D.N.C. 1991) 14

Katz v. First of Michigan, No. K87-264 CA4, 1989 U.S. Dist. LEXIS 19141 (W.D. Mich. Mar. 13, 1989) 14

MBI Acquisition Partners, L.P. v. The Chronicle Publishing Co., No. 01-C-177-C, 2001 U.S. Dist. LEXIS 15387 (W.D. Wis. Sept. 6, 2001) 14, 17

One-O-One Enterprises, Inc. v. Caruso, 848 F.2d 1283 (D.C. Cir. 1988) 13, 14

Rissman v. Rissman, 213 F.3d 381 (7th Cir. 2000) ... 13

Rissman v. Rissman, No. 98 C 3656, 1999 U.S. Dist. LEXIS 10611 (N.D. Ill. June 30, 1999), *aff'd*, 213 F.3d 381 (7th Cir. 2000) 14

Cited Authorities

Page

Rogen v. Ilikon, 361 F.2d 260 (1st Cir. 1966) 14, 15

Shearson/American Express, Inc. v. McMahon, 482 U.S. 220 (1987) 13, 18, 19, 20

Wilko v. Swan, 346 U.S. 427 (1953) 19

Statutes and Rules

15 U.S.C. § 78aa 8

15 U.S.C. § 78u-4(b)(3)(B) 9

15 U.S.C. § 78cc ..... *passim*

28 U.S.C. § 1331 8

28 U.S.C. § 1337 8

28 U.S.C. § 1404 9

Securities and Exchange Commission Rule 10b-5 ..... 2, 14

Tex. Rev. Civ. Stat. Ann. Art. 581 § 33A(2) 2

Tex. Rev. Civ. Stat. Ann. Art. 581 § 33F 2

Tex. Bus. & Com. Code Ann. § 27.01 2

No. 03-272

IN THE

Supreme Court of the United States

THE DOW CHEMICAL COMPANY,

Petitioner,

v.

THE AES CORPORATION,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF IN OPPOSITION

Before the Court is a petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Third Circuit, filed by The Dow Chemical Company ("Dow"). Respondent The AES Corporation ("AES") has filed a conditional cross-petition for a writ of certiorari to review the judgment. The petition by Dow should be denied. Contrary to petitioner's arguments, the decision below does not create a conflict among multiple circuits that requires

resolution by this Court, nor does it conflict with any prior decision of this Court. Rather, the court below correctly applied the standards articulated by this Court in its prior decisions interpreting Section 29(a) of the Securities Exchange Act of 1934 (the "Exchange Act") to the facts of this case and properly concluded that enforcement of the non-reliance and merger clauses at issue in this case to bar AES's fraud claims under the Exchange Act as a matter of law would violate Section 29(a).

COUNTER-STATEMENT OF THE CASE

A. The Fraud by Dow and Destec

This case was brought by AES against Dow and Dynegy Power Corporation (formerly Destec Energy, Inc.) ("Destec"), formerly a subsidiary of Dow. The Amended Complaint alleges that Dow and Destec violated Sections 10(b) and 20(a) of the Exchange Act and Securities and Exchange Commission Rule 10b-5, Sections 33A(2) and 33F of the Texas Securities Act, Section 27.01 of the Texas Business and Commerce Code, and participated in fraud, negligent misrepresentations and a civil conspiracy, in connection with a transaction in which AES purchased 100% of the stock of an international subsidiary of Destec, Destec Engineering, Inc. ("DEI"), in 1997.[1] (C.A. App. A32, ¶ 1; A68-89, ¶¶ 66-177.)

The Amended Complaint describes a comprehensive scheme by Dow to sell Destec at an artificially inflated price by misrepresenting the financial worth and prospects of DEI. (*Id.* at A32, ¶ 1; A55-A57, ¶¶ 53-61.) As part of this scheme,

[1] AES's claims against Destec were resolved by means of a settlement and, thus, only its claims against Dow remain.

Dow and Destec knowingly and recklessly disseminated false and misleading information to AES, and withheld material information from AES, regarding DEI's sole asset, a contract to engineer, procure and construct a power plant in Terneuzen, The Netherlands ("the Elsta Project"). (*Id.* at A32-A33, ¶¶ 1-2; A43-A44, ¶¶ 28-29; A57-A67, ¶¶ 62-65.) Dow and Destec falsely represented to AES, in numerous documents and oral presentations, that the Elsta Project would be substantially complete by September 30, 1997, and would result in a profit of $31 million for DEI. (*Id.* at A33, ¶ 2; A57, ¶ 62.)

These misrepresentations and omissions fraudulently induced AES to enter into the stock purchase transaction and caused AES to pay a vastly inflated price for the shares of DEI. (*Id.* at A33, ¶ 2.) AES paid dollar for dollar the value that Dow and Destec placed on the Elsta Project during due diligence for the stock purchase transaction, and thus paid $31 million for the shares of DEI. (*Id.* at A52, ¶ 46.) When AES took over the Elsta Project after the consummation of the transaction, it shortly discovered that the Project was far behind schedule and far from completion, and thus represented a substantial loss to DEI, rather than the $31 million profit that was promised by Dow and Destec. (*Id.* at A54, ¶¶ 51-52.) The Elsta Project finally was complete on September 19, 1998, almost a full year after the represented completion date, and the Project has represented a loss in excess of $70 million to AES. (*Id.* at A33, ¶ 2.) Thus, AES has been damaged by more than $100 million by Dow and Destec's dishonesty during the negotiation of the stock purchase transaction. (*Id.*)

AES first expressed an interest in acquiring Destec's international assets, including DEI, in October 1996. (*Id.* at

A47, ¶ 36.) Before Destec or Dow would provide AES with any information regarding Destec's assets, Destec required AES to sign a Confidentiality Agreement. (*Id.* at A118; A194-A198.) As Dow concedes, AES signed the Confidentiality Agreement on October 24, 1996, before it had conducted any due diligence on Destec or even had decided to pursue the transaction. (*Id.* at A118.) The Confidentiality Agreement contained the following provision, which required AES to waive all potential claims under the securities laws prior to receiving any information regarding Destec:

> We [AES] acknowledge that neither you [Destec], nor Morgan Stanley [Destec's Investment Banker] or its affiliates, nor your other Representatives, nor any of your or their respective officers, directors, employees, agents or controlling persons within the meaning of section 20 of the Securities Exchange Act of 1934, as amended, make any express or implied representation or warranty as to the accuracy or completeness of the Information, and we agree that no such person will have any liability relating to the Information or for any errors therein or omissions therefrom. We further agree that we are not entitled to rely on the accuracy or completeness of the Information and that we will be entitled to rely solely on any representations and warranties as may be made to us in any definitive agreement with respect to the Transaction, subject to such limitations and restrictions as may be contained therein.

(*Id.* at A197, ¶ 5.) Dow was not a party to the Confidentiality Agreement.

Five days later, Destec sent AES a unilateral offering memorandum (the "Offering Memorandum") which, as later revelations demonstrated, contained material misrepresentations about Elsta Project, including the representation that the Project would result in a $38 million profit for DEI, and that the plant would be commercially operational on October 1, 1997. (*Id.* at A47, ¶¶ 35-36; A57, ¶ 62; A318-A322.) The Offering Memorandum also included a disclaimer by Destec of all liability under the securities laws based on "the information contained herein or made available in connection with any further investigation of Destec," and further stated that AES "shall be entitled to rely solely on any representations and warranties made to it by Destec in any final acquisition agreement, if any." (*Id.* at A319.) Based on the representations made in the Offering Memorandum, AES became interested in purchasing the international assets of Destec. (*Id.* at A47, ¶ 36.)

During the course of due diligence in late 1996 and early 1997, when AES repeatedly sought to determine the financial condition and construction status of the Elsta Project, Dow and Destec repeatedly provided AES with false written and oral information. Dow and Destec made documents available to AES and other potential bidders in a document room in Houston, Texas, and allowed AES to interview certain Destec employees. (*Id.* at A48, ¶ 37.) However, the written and oral information provided to AES through these sources about the Elsta Project was uniformly consistent with the information in the Offering Memorandum, and thus prevented AES from discovering the true facts about the status of the Project and the true value of the DEI shares. (*Id.* at A57, ¶ 62.) When AES made further attempts to confirm that the information Dow and Destec had provided to AES about the Elsta Project was true by visiting the Elsta

plant in person with its experts, AES and its experts again were misled by Destec employees with false information. (*Id.* at A51-A52, ¶¶ 44-45; A57, ¶ 62.)

The Amended Complaint alleges specific facts known to Dow and Destec that contradict the optimistic representations that they made during due diligence about the Elsta Project, which show that Dow and Destec intentionally misled AES prior to the consummation of the transaction. (*Id.* at A61, ¶ 65.) The Amended Complaint identifies numerous internal Dow and Destec documents that AES found at the Elsta site after the sale which show that Dow and Destec knew before and during the due diligence process that the actual cost of the Elsta Project to-date was understated and could not be verified. (*Id.* at A61, ¶ 65(b).) A document dated within days of an assurance to AES that there would be no reduction in the Elsta Project's $31 million profit, for example, states that the project's profit was "going south." (*Id.* at A62, ¶ 65(d).) No one gave AES any such information.

The numerous material misrepresentations and omissions by Dow and Destec concerning the Elsta Project, which were communicated to AES both orally and in writing, induced AES to enter into a contract to purchase the international assets of Destec, including DEI, for $407 million in February 1997. (*Id.* at A33, ¶ 2; A52-A53, ¶¶ 47-48.) The purchase was part of a larger transaction in which AES and NGC Corporation ("NGC") together purchased Destec from Dow. NGC purchased Destec's domestic assets and AES purchased Destec's international assets. (*Id.* at A52-A53, ¶¶ 47-48.)

The purchase transaction was structured in two steps. First, on February 17, 1997, Dow, Destec and NGC entered

into the Agreement and Plan of Merger by and among Destec Energy, Inc., The Dow Chemical Company, NGC Corporation and NGC Acquisition Corporation II (the "Merger Agreement"), whereby NGC purchased all of Destec from Dow. (*Id.* at A53, ¶ 48; A199-A268.) Second, on February 17, 1997, NGC and AES entered into the Asset Purchase Agreement by and between NGC Corporation and The AES Corporation (amended June 29, 1997) (the "Asset Purchase Agreement"), whereby AES purchased the international assets of Destec, including the shares of DEI, from NGC. (*Id.* at A53, ¶ 48; A269-A316.)

The Merger Agreement, to which AES was not a party, included a clause which stated that: "[e]xcept for the representations and warranties contained in this Article IV, neither Dow nor any other Person makes any other express or implied representation or warranty on behalf of Dow." (*Id.* at A235, § 4.6.) A parallel provision applied to Destec. (*Id.* at A233, § 3.20.) The Merger Agreement contained very limited substantive warranty provisions. (*Id.* at A215-A233, §§ 3.1-3.20; A233-A234, §§ 4.1-4.6.) Most of the warranties by Dow and Destec address the technicalities related to the sale and have nothing to do with the assets of Destec ultimately purchased by AES. None of the warranties mentions the Elsta Project or, for that matter, any other part of the actual business of Destec. The warranties, instead, contained little more than the standard terms needed to effect the stock transaction.

The Merger Agreement also included a merger clause, which provided that "[t]his Agreement and the Confidentiality Agreement, and certain other agreements executed by the parties hereto as of the date of this Agreement, constitute the entire agreement, and supersedes

all prior agreements and understandings (written and oral), among the parties with respect to the subject matter hereof." (*Id.* at A265, § 9.9.)

The Asset Purchase Agreement executed by AES and NGC also included a clause which stated that, "[e]xcept for the representations and warranties contained in this Article III, neither NGC nor any other Person (as defined in the Merger Agreement) makes any other express or implied representation or warranty on behalf of NGC." (*Id.* at A280-A281, § 3.4.) The Asset Purchase Agreement also included a standard merger clause.[2] The substantive warranty provisions included in the Asset Purchase Agreement were even more limited than those included in the Merger Agreement and none related to the Elsta Project or to Destec's assets. (*Id.* at A279-A281, §§ 3.1-3.4.)

B. Proceedings Below

AES brought this action against Dow in the United States District Court for the Southern District of Texas on November 30, 1998, alleging, *inter alia*, federal securities fraud in connection with AES's purchase of DEI's stock.[3] On September 29, 1999, upon Dow's motion, the case was

---

[2] The merger clause stated: "[t]his Agreement constitutes the entire agreement, and supersedes all prior agreements and understandings (written and oral), among the parties with respect to the subject matter hereof, including, without limitation, that certain Joint Bidding Agreement, dated February 10, 1997, by and between Parent and NGC." (*Id.* at A298, § 9.9.)

[3] Federal subject matter jurisdiction was based on Section 27 of the Exchange Act, 15 U.S.C. § 78aa, and 28 U.S.C. §§ 1331 and 1337.

transferred pursuant to 28 U.S.C. § 1404(a) to the United States District Court for the District of Delaware.

On January 7, 2000, Dow moved to dismiss the Amended Complaint for failure to state a claim upon which relief could be granted. Discovery was automatically stayed during the pendency of that motion pursuant to Section 21D(b)(3)(B) of the Private Securities Litigation Reform Act ("PSLRA"), 15 U.S.C. § 78u-4(b)(3)(B). In support of its motion to dismiss, Dow argued, *inter alia*, that the merger and non-reliance clauses included in the agreements for the stock purchase transaction precluded AES, as a matter of law, from proving that it had reasonably relied on the alleged fraudulent misrepresentations by Dow and Destec. The district court denied the motion to dismiss on January 19, 2001. (C.A. App. at A92-A110.) In denying the motion, the district court found that AES had adequately alleged facts to support its claim that Dow and Destec had fraudulently misrepresented the value of DEI to AES in the course of the stock purchase transaction. (*Id.* at A96.) The district court declined to address Dow's argument concerning the merger and non-reliance clauses, finding that it would be more appropriately raised on a motion for summary judgment. (*Id.* at A103.)

On March 2, 2001, Dow filed a motion for summary judgment, and on March 5, 2001, moved to stay discovery pending resolution of the summary judgment motion. At a March 8, 2001 conference between the parties, the district court granted the discovery stay. In support of its motion, Dow relied solely on the written agreements for the stock purchase transaction. Dow argued that the merger and non-reliance clauses included in the Confidentiality Agreement, the Offering Memorandum, the Merger Agreement and the Asset Purchase Agreement precluded

AES, as a matter of law, from establishing its justifiable reliance on any representations not contained in the parties' final written agreements for the transaction.

On August 2, 2001, the district court granted Dow's motion for summary judgment on AES's federal securities law claims. The district court held that as a result of the merger and non-reliance clauses, AES's reliance on Dow's misrepresentations was unreasonable as a matter of law, foreclosing AES's ability to pursue any claim under the federal securities laws. The district court rejected AES's argument that the clauses cannot be given such force in light of Section 29(a) of the Exchange Act. The district court concluded that in the circumstances of this case, "Section 29(a) of the Exchange Act does not bar the enforcement of a clause disclaiming representations and warranties not appearing in a final agreement negotiated between sophisticated parties in an arm's length transaction." (Pet. App. 30a.) It then dismissed the state law claims by AES for lack of jurisdiction.

The Third Circuit reversed the judgment of the district court on April 14, 2003. It held that "enforcement of the non-reliance clauses to bar AES's fraud claims as a matter of law would be inconsistent with Section 29(a)." (Pet. App. 9a.) The Third Circuit reasoned, as the First Circuit had in *Rogen v. Ilikon*, 361 F.2d 260 (1st Cir. 1966), that the clauses were waivers of compliance with the Exchange Act within the meaning of Section 29(a) because there is "'no fundamental difference between saying . . . "I waive any rights I might have because of your representations or obligations to make full disclosure" and "I am not relying on your representations or obligations to make full disclosure."'" (Pet. App. 10a.) The Third Circuit further reasoned that Section 29(a)

"expressly forecloses contracting parties from 'defin[ing] the boundaries of the[ir] transaction' in a way that relieves a party of the duties imposed by [the Exchange] Act." (Pet. App. 16a.)

The Third Circuit went on to explain that "this is not to say that a plaintiff's declaration in a contract of an intent not to rely may not be evidence that he or she did not rely on representations of the defendants." (Pet. App. 11a.) It found that "[t]hat declaration, alone or in conjunction with other evidence of non-reliance, may establish an absence of reliance and, when unrebutted, may even provide a basis for summary judgment in the defendant's favor." (*Id.*) In this case, however, it found that the evidence of non-reliance was rebutted by AES and that "Dow does not contend that the information provided by it and its associates played no material role in AES's decision to enter the agreement." (*Id.*).

The Third Circuit remanded the case to the district court to consider, in light of all of the relevant facts, the reasonableness of AES's reliance on Dow and Destec's alleged misrepresentation. In describing the issue for decision on remand, the Third Circuit explained that "[t]he non-reliance clauses are, of course, among the circumstances to be considered in determining the reasonableness of any reliance here." (Pet. App. 12a.)

One of the three Circuit Judges filed an opinion concurring and dissenting in part from the opinion of the majority. Circuit Judge Wallace concurred with the reversal of the district court's judgment, but dissented from the majority's holding that the merger and non-reliance clauses could be used as evidence that AES's reliance on Dow's misstatements was unreasonable. (Pet. App. 17a.) Circuit

Judge Wallace found that the merger and non-reliance clauses at issue in the case "are waivers of compliance [with the Securities Exchange Act], and under the express terms of section 29, they are 'void.'" (*Id.*) Noting that "[t]he majority holds that the void stipulation can nonetheless be evidence of the reasonableness of AES's reliance," he wrote "separately because I cannot join in the majority's interpretation of the word 'void.'" (*Id.*) Citing the plain meaning of the word, Circuit Judge Wallace wrote that "[i]f we permit the void stipulation to have evidentiary value, it is no longer a nullity, ineffective, or useless." (Pet. App. 17a-18a.) "Instead," he explained, "it becomes a very potent weapon in the 10b-5 defendant's arsenal. This is precisely what section 29(a) prohibits." (Pet. App. 18a.) Circuit Judge Wallace concluded:

> To permit the void stipulation to serve as evidence of a lack of reasonable reliance would be to take the teeth out of section 29. It would make a 10b-5 claim logically possible, but essentially hopeless. Congress meant more when it enacted section 29(a).

(*Id.*).

Dow filed timely petitions for re-hearing and re-hearing en banc on April 28, 2003. The Third Circuit denied Dow's petitions on May 13, 2003. (Pet. App. 33a-34a.)

REASONS FOR DENYING THE PETITION

The Third Circuit's decision does not, as petitioner contends, create a conflict among multiple circuits on the issue of the enforceability of merger and non-reliance clauses under Section 29(a) that requires resolution by this Court at this time. Nor does it conflict with this Court's prior decision

in *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987). Rather, the Third Circuit correctly applied the standards articulated by this Court in *Shearson* to the facts of this case to properly conclude that the mere inclusion of merger and non-reliance clauses in the agreements for the stock purchase transaction cannot bar AES's fraud claims under the Exchange Act as a matter of law under Section 29(a).

I. The Third Circuit's Decision Does Not Create Multiple Conflicts with Other Circuits

Petitioner argues that this Court should grant certiorari to settle the issue of whether Section 29(a) of the Exchange Act limits the enforceability of merger and non-reliance clauses in a negotiated agreement for the sale of securities. (Pet. 13.) The Third Circuit's decision, however, does not create a conflict among multiple circuits on this issue that requires resolution by this Court.

The Third Circuit's decision does not, as petitioner contends, conflict with decisions by the Seventh, First and D.C. Circuits. In *Rissman v. Rissman*, 213 F.3d 381 (7th Cir. 2000), *Jackvony v. RIHT Financial Corp.*, 873 F.2d 411 (1st Cir. 1989) (Breyer, J.), and *One-O-One Enterprises, Inc. v. Caruso*, 848 F.2d 1283 (D.C. Cir. 1988) (Ruth Bader Ginsburg, J.), the Seventh, First and D.C. Circuits did not address, let alone mention, Section 29(a) or the question presented by this case of whether that statutory provision bars or otherwise limits the enforceability of merger and non-reliance clauses in a contract for the sale of securities.[4]

---

[4] The district court in *Rissman*, moreover, did not, as petitioner suggests, address and "specifically reject[]" the argument that the non-reliance clauses at issue in that case were unenforceable under

(Cont'd)

The First Circuit's decision in *One-O-One Enterprises, Inc.*, moreover, does not discuss or even cite its prior decision in *Rogen v. Ilikon Corp.*, 361 F.2d 260 (1st Cir. 1966), which, thirty-three years earlier, considered the effect of Section 29(a) on a non-reliance clause in a contract for the sale of stock. There is no conflict between the Third Circuit's decision and this prior decision by the First Circuit. In *Rogen*, the former president and largest single stockholder of the defendant corporation brought suit alleging that during negotiations for the sale of his stock, the officers and directors of the corporation failed to disclose material information about the possibility of new prospects for the company.

(Cont'd)

Section 29(a). (Pet. 19.) The district court, instead, concluded that there was no basis for the plaintiff's 10b-5 claims and, accordingly, that "we need not address the import of Section 29(a) of the Securities Exchange Act, 15 U.S.C. § 78cc(a) on the Agreement and its releases." *Rissman v. Rissman*, No. 98 C 3656, 1999 U.S. Dist. LEXIS 10611, at *47 (N.D. Ill. June 30, 1999), *aff'd*, 213 F.3d 381 (7th Cir. 2000). Because the district court did not decide the question of the effect of Section 29(a) on the non-reliance clauses, the Seventh Circuit did not address that issue on appeal.

Lower courts in the Seventh Circuit and other circuits, however, have addressed the question of the effect of Section 29(a) on merger and non-reliance clauses in other cases. Like the Third and First Circuits, these courts have held that merger and non-reliance clauses are void because they weaken a plaintiff's ability to recover under the federal securities laws and, thus, may not be invoked to bar a plaintiff's federal securities claims as a matter of law. *See MBI Acquisition Partners, L.P. v. The Chronicle Publ'g Co.*, No. 01-C-0177-C, 2001 U.S. Dist. LEXIS 15387, at *25 (W.D. Wis. Sept. 6, 2001), *FS Photo Inc. v. Picturevision Inc.*, 61 F. Supp. 2d 473, 480-81 (E.D. Va. 1999); *Jadoff v. Gleason*, 140 F.R.D. 330, 333-34 (M.D.N.C. 1991); *Katz v. First of Michigan*, No. K87-264 CA4, 1989 U.S. Dist. LEXIS 19141, at *30-*31 (W.D. Mich. Mar. 13, 1989).

The district court granted summary judgment after finding no non-disclosure or misrepresentation of material fact and no reasonable reliance by the plaintiff on any such non-disclosure. *Id.* at 266. In reviewing the district court's finding of non-reliance as a matter of law, the First Circuit considered whether Section 29(a) precluded such a finding based on the inclusion of a non-reliance clause in the contract for the sale of the plaintiff's stock. The First Circuit held that, under Section 29(a), the existence of a non-reliance clause could not "constitute[] the basis (or a substantial part of the basis) for finding non-reliance as a matter of law." *Id.*

In the last thirty-five years, the Second Circuit is the only other circuit to have considered the enforceability of merger and non-reliance clauses under Section 29(a). While the Third Circuit declined in this case to adopt the reasoning of the Second Circuit in *Harsco v. Segui*, 91 F.3d 337 (2d Cir. 1996), there are significant factual differences between this case and *Harsco*.

In *Harsco*, the Second Circuit conceded that the non-reliance clause in that case could "be described as weakening Harsco's ability to recover under § 10(b) of the Exchange Act." *Id.* at 343. The Second Circuit, however, further found "that *in the circumstances of this case* such a 'weakening' does not constitute a forbidden waiver of compliance" under Section 29(a). *Id.* (emphasis added). The Second Circuit concluded that the *Harsco* case not only involved a "detailed writing developed via negotiations among sophisticated business entities and their advisors," *id.*, but that "Harsco further protected itself by negotiating for two weeks of confirmatory due diligence – the purpose of which was to confirm the accuracy of MultiServ's disclosures" and that it could have terminated the deal if it had been unable to

confirm the truth of the detailed disclosures and representations during that due diligence period. *Id.* at 344. The Second Circuit concluded that, "[i]n short there is nothing in the complaint or the Agreement that indicates that Harsco was duped into waiving the protections of the securities laws." *Id.*

In contrast, the factual record in this case reveals that AES, unlike the plaintiff in *Harsco*, was "duped" into waiving the protections of the securities laws. AES alleges that it attempted to determine the financial condition and construction status of the Elsta Project repeatedly during the due diligence process, but consistently was provided with false written and oral information by Dow and Destec that frustrated its efforts. AES, unlike Harsco, thus had no real opportunity to confirm the accuracy of the information it was provided concerning the Elsta Project as a result of Dow and Destec's fraud. Because AES had no access to truthful and reliable information about the Elsta Project despite its diligent attempts to verify the information provided by Dow and Destec, it was not in a position to protect itself by negotiating detailed representations and warranties relating to the Project.

Given these significant factual differences, there is no reason to believe that the Second Circuit, if presented with this case, would reach the same result as it did in *Harsco*. The Second Circuit's decision in *Harsco* does not, as petitioner contends, suggest that merger and non-reliance clauses can never "weaken" a plaintiff's ability to recover under the Exchange Act to such an extent that it constitutes "a forbidden waiver of compliance" with the provisions of the Act. *Cf.* 91 F.3d at 343. Instead, the Second Circuit in *Harsco* decided only that "in the circumstances of [that] case," the weakening of Harsco's ability to recover under

the Exchange Act did not constitute such a forbidden waiver of compliance. *Id.* In fact, in a case presenting facts substantially similar to those of this case where the plaintiff alleged that it was "duped" into waiving the protections of the securities laws, a lower court in the Seventh Circuit declined to follow *Harsco* and instead concluded that the Second Circuit's reasoning in *Harsco* was limited to the facts of that case. *See MBI Acquisition Partners, L.P. v. The Chronicle Publishing Co.*, No. 01-C-177-C, 2001 U.S. Dist. LEXIS 15387, at * 23-*25 (W.D. Wis. Sept. 6, 2001).

Even if the Second Circuit were to reach the same result in this case as it did in *Harsco*, this case presents a poor vehicle for the resolution of any conflict between the Second and Third Circuits on the enforceability of merger and non-reliance clauses under Section 29(a). The question at issue in this case has arisen at the interlocutory summary judgment stage before the taking of any discovery. On remand, and after discovery is conducted, the district court may yet grant summary judgment in favor of Dow, in consideration of the merger and non-reliance clauses at issue. If that were to happen, the question Dow presents for review in its petition would be moot.

A grant of certiorari to review the issue of the enforceability of merger and non-reliance clauses under Section 29(a) in this case also would be premature where only two of the twelve circuits have considered the issue in the last thirty-five years. If, as petitioner contends, this issue is "likely to arise again and again in significant corporate transactions" (Pet. 13), the Court would benefit from allowing the issue to further percolate in the lower courts before settling the matter.

II. The Third Circuit's Decision Does Not Conflict with This Court's Opinion in *Shearson*

Petitioner argues that review by this Court also is necessary because the Third Circuit's decision "misinterprets" this Court's decision in *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987). (Pet. 24.) Petitioner's argument is incorrect and based on a mis-reading both of this Court's decision in *Shearson* and of the decision of the Third Circuit. The Third Circuit correctly applied the standards articulated by this Court in *Shearson* to find that it would offend Section 29(a) to bar AES's claims under the Exchange Act as a matter of law based solely on the inclusion of the merger and non-reliance clauses in the agreements for the stock purchase transaction.

In *Shearson*, the plaintiffs argued, *inter alia*, that Section 29(a) barred the enforcement of pre-dispute arbitration agreements between a securities broker and his or her customers because of the "frequent inequality of bargaining power" between the parties. 482 U.S. at 230. The Court rejected this "unlikely interpretation" of Section 29(a), and held that "[t]he concern that § 29(a) is directed against is evident from the statute's plain language: it is a concern with whether an agreement 'waive[s] compliance with [a] provision' of the Exchange Act." *Id.* The Court held that "[t]he voluntariness of the agreement is irrelevant to this inquiry: if a stipulation waives compliance with a statutory duty, it is void under § 29(a), whether voluntary or not." *Id.* The Court explained, "[t]hus, a customer cannot negotiate a reduction in commissions in exchange for a waiver of compliance with the requirements of the Exchange Act, even if the customer knowingly and voluntarily agreed to the bargain." *Id.* The Court went on to hold that Section 29(a)

"is concerned, not with whether brokers 'manuever[ed customers] into' an agreement, but with whether the agreement 'weaken[s] their ability to recover under the [Exchange] Act.'" *Id.* (quoting *Wilko v. Swan*, 346 U.S. 427, 432 (1953)) (alterations in original). The latter, it found, "is grounds for voiding the agreement under § 29(a)." *Id.* at 231. The Third Circuit correctly applied these standards, and considered whether the merger and non-reliance clauses in the agreements "weaken[ed]" AES's ability to recover under the Exchange Act. (Pet. App. 8a.)

Petitioner argues that the Third Circuit misinterpreted this Court's decision in *Shearson* as "compelling the conclusion that, no matter how sophisticated the parties or how detailed their agreement, a non-reliance clause can never be dispositive of the issue of reliance in a federal securities fraud case." (Pet. 25.) *Shearson*, however, makes clear that factors such as the voluntariness of the contractual provision or the sophistication of the parties are irrelevant to the question of whether the provision waives compliance with a statutory duty or weakens the plaintiff's ability to recover under the Exchange Act. The Third Circuit, thus, properly concluded that Section 29(a) is not "susceptible of [a] reading that would make an exception for sophisticated parties and detailed agreements." (Pet. App. 16a.)

The Third Circuit's decision accords not only with this Court's holding in *Shearson,* but also with the plain language of Section 29(a). The plain language of the statute does not distinguish between the parties it protects. Rather, it prohibits the enforcement of "*[a]ny* condition, stipulation, or provision binding *any* person to waive compliance with *any* provision" of the Exchange Act. 15 U.S.C. § 78cc(a) (emphasis added).

Petitioner argues that the Third Circuit's rationale is "circular" because "Section 29(a) does not come into play unless the court first decides that the plaintiff had a viable claim under the federal securities laws." (Pet. 25.) Petitioner's argument incorrectly pre-supposes that Section 29(a) applies only to existing or matured claims. The statutory language and this Court's decision in *Shearson* establish that anticipatory waivers of unmatured claims are barred by Section 29(a). Petitioner's argument, moreover, ignores the important fact that in this case, the district court already has concluded, in its denial of Dow's prior motion to dismiss, that AES has stated a viable claim under the federal securities laws.

III. The Third Circuit's Decision Will Not Result in the Negative Consequences for Negotiated Securities Transactions Predicted by Petitioner

Petitioner contends that the failure to enforce merger and non-reliance clauses will result in a host of negative consequences for negotiated securities transactions, including the promotion of uncertainty in commercial relationships and impediments to the "free flow of information." (Pet. 22-23.) However, petitioner's contentions are not supported by the facts of this case.

This case is not, as petitioner suggests, analogous to one in which a company merely shared with a counterparty its internal projections, or allowed a bidder to speak directly to its employees. The Amended Complaint cites numerous documents in which Dow knowingly and purposely lied in order to induce AES to purchase the shares of DEI. As a result, AES was unable to engage in fair, good-faith negotiations about the merger and non-reliance clauses and

the representations and warranties contained in the final agreements for the transaction. The facts of this case, thus, are easily distinguishable from one in which a buyer engaged in "sharp practices" by "reneg[ing]" on a contract provision. (Pet. 24.) Here, AES was "duped" into the contract terms by the pervasive fraud undertaken by Dow and Destec.

Furthermore, because many, if not most, of AES's allegations of fraud by Dow concern written, rather than oral, misrepresentations, this case also does not implicate concerns about the risks of unmanageable future litigation over the true intent and meaning of prior oral statements. Here, there can be no dispute as to what Dow and Destec represented to AES to fraudulently induce it to purchase the DEI stock.

CONCLUSION

For the reasons set forth above, the petition for a writ of certiorari filed by Dow should be denied.

Dated: New York, New York
September 18, 2003

Respectfully submitted,

JAMES W.B. BENKARD
Counsel of Record
FRANCES E. BIVENS
KELLI J. STENSTROM
DAVIS POLK & WARDWELL
450 Lexington Avenue
New York, New York 10017
(212) 450-4000

Attorneys for Respondent
The AES Corporation